

**Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Reduce Phlx's Options Regulatory Fee**

January 26, 2022.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 20, 2022, Nasdaq PHLX LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend Phlx's Pricing Schedule at Options 7, Section 6, Part D to reduce the Phlx Options Regulatory Fee or "ORF".

While the changes proposed herein are effective upon filing, the Exchange has designated the amendments become operative on February 1, 2022.

The text of the proposed rule change is available on the Exchange's website at <https://listingcenter.nasdaq.com/rulebook/phlx/rules>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Phlx previously filed to waive its ORF from October 1, 2021 through January 31, 2022.<sup>3</sup> The Waiver Filing provided that Phlx would continue monitoring the amount of revenue collected from the ORF to determine if regulatory revenues would exceed regulatory costs when it recommenced assessing ORF on February 1, 2022. If so, the Exchange committed to adjust its ORF.<sup>4</sup> At this time, after a review of its regulatory revenues and regulatory costs, the Exchange proposes to reduce the ORF from \$0.0042 (the amount of the ORF prior to the waiver) to \$0.0034 per contract side as of February 1, 2022, to ensure that revenue collected from the ORF, in combination with other regulatory fees and fines, does not exceed the Exchange’s total regulatory costs.

The options industry continues to experience high options trading volumes and volatility. At this time, Phlx believes that the options volume it experienced in the second half of 2021 is likely to persist into 2022. The anticipated options volume would impact Phlx’s ORF collection which, in turn, has caused Phlx to propose reducing the ORF to ensure that revenue collected from the ORF, in combination with other regulatory fees and fines, would not exceed the Exchange’s total regulatory costs.

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<sup>3</sup> See Securities Exchange Act Release No. 92585 (August 5, 2021), 86 FR 44096 (August 11, 2021) (SR-Phlx-2021-39) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Phlx’s Options Regulatory Fee) (“Waiver Filing”).

<sup>4</sup> Id. at 44098.

## *Collection of ORF*

Upon recommencement of the ORF on February 1, 2022,<sup>5</sup> Phlx will assess its ORF for each customer option transaction that is either: (1) executed by a member organization<sup>6</sup> on Phlx; or (2) cleared by a Phlx member organization at The Options Clearing Corporation (“OCC”) in the customer range,<sup>7</sup> even if the transaction was executed by a non-member organization of Phlx, regardless of the exchange on which the transaction occurs.<sup>8</sup> If the OCC clearing member is a Phlx member organization, ORF will be assessed and collected on all cleared customer contracts (after adjustment for CMTA<sup>9</sup>); and (2) if the OCC clearing member is not a Phlx member organization, ORF will be collected only on the cleared customer contracts executed at Phlx, taking into account any CMTA instructions which may result in collecting the ORF from a non-member organization.<sup>10</sup>

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<sup>5</sup> Prior to the Waiver Filing, the Exchange similarly collected ORF as described herein.

<sup>6</sup> The term “member organization” means a corporation, partnership (general or limited), limited liability partnership, limited liability company, business trust or similar organization, transacting business as a broker or a dealer in securities and which has the status of a member organization by virtue of (i) admission to membership given to it by the Membership Department pursuant to the provisions of General 3, Sections 5 and 10 or the By-Laws or (ii) the transitional rules adopted by the Exchange pursuant to Section 6-4 of the By-Laws. References herein to officer or partner, when used in the context of a member organization, shall include any person holding a similar position in any organization other than a corporation or partnership that has the status of a member organization. See General 1, Section 1(17).

<sup>7</sup> Participants must record the appropriate account origin code on all orders at the time of entry of the order. The Exchange represents that it has surveillances in place to verify that member organizations mark orders with the correct account origin code.

<sup>8</sup> The Exchange uses reports from OCC when assessing and collecting the ORF.

<sup>9</sup> CMTA or Clearing Member Trade Assignment is a form of “give-up” whereby the position will be assigned to a specific clearing firm at OCC.

<sup>10</sup> By way of example, if Broker A, a Phlx member organization, routes a customer order to CBOE and the transaction executes on CBOE and clears in Broker A’s OCC Clearing account, ORF will be collected by Phlx from Broker A’s clearing account at OCC via direct debit. While this transaction was executed on a market other than Phlx, it was cleared by a Phlx member organization in the member organization’s OCC clearing account in the customer range, therefore there is a regulatory nexus between Phlx and the transaction. If Broker A was not a Phlx member organization, then no ORF should be assessed and collected because there is no nexus; the transaction did not execute on Phlx nor was it cleared by a Phlx member organization.

In the case where a member organization both executes a transaction and clears the transaction, the ORF will be assessed to and collected from that member organization. In the case where a member organization executes a transaction and a different member organization clears the transaction, the ORF will be assessed to and collected from the member organization who clears the transaction and not the member organization who executes the transaction. In the case where a non-member organization executes a transaction at an away market and a member organization clears the transaction, the ORF will be assessed to and collected from the member organization who clears the transaction. In the case where a member executes a transaction on Phlx and a non-member organization clears the transaction, the ORF will be assessed to the member organization that executed the transaction on Phlx and collected from the non-member organization who cleared the transaction. In the case where a member organization executes a transaction at an away market and a non-member organization clears the transaction, the ORF will not be assessed to the member organization who executed the transaction or collected from the non-member organization who cleared the transaction because the Exchange does not have access to the data to make absolutely certain that ORF should apply. Further, the data does not allow the Exchange to identify the member organization executing the trade at an away market.

#### *ORF Revenue and Monitoring of ORF*

The Exchange monitors the amount of revenue collected from the ORF to ensure that it, in combination with other regulatory fees and fines, does not exceed regulatory costs. In determining whether an expense is considered a regulatory cost, the Exchange reviews all costs and makes determinations if there is a nexus between the expense and a regulatory function. The Exchange notes that fines collected by the Exchange in connection with a disciplinary matter offset ORF.

Revenue generated from ORF, when combined with all of the Exchange's other regulatory fees and fines, is designed to recover a material portion of the regulatory costs to the

Exchange of the supervision and regulation of member<sup>11</sup> and member organization customer options business including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities.

Regulatory costs include direct regulatory expenses and certain indirect expenses in support of the regulatory function. The direct expenses include in-house and third-party service provider costs to support the day-to-day regulatory work such as surveillances, investigations and examinations. The indirect expenses include support from such areas as Office of the General Counsel, technology, and internal audit. Indirect expenses were approximately 38% of the total regulatory costs for 2021. Thus, direct expenses were approximately 62% of total regulatory costs for 2021.<sup>12</sup>

The ORF is designed to recover a material portion of the costs to the Exchange of the supervision and regulation of its members and member organizations, including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities.

### Proposal

Based on the Exchange's most recent review, the Exchange is proposing to reduce the amount of ORF that will be collected by the Exchange from \$0.0042 per contract side to \$0.0034 per contract side. The Exchange issued an Options Trader Alert on December 31, 2021 indicating the proposed rate change for February 1, 2022.<sup>13</sup>

The proposed reduction is based on a sustained high level of options volume in 2021. The below table displays average daily volume for 2021.<sup>14</sup>

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<sup>11</sup> The term "member" means a permit holder which has not been terminated in accordance with the By-Laws and these Rules of the Exchange. A member is a natural person and must be a person associated with a member organization. Any references in the rules of the Exchange to the rights or obligations of an associated person or person associated with a member organization also includes a member. See General 1, Section 1(16).

<sup>12</sup> The Exchange will set a 2022 Regulatory Budget in the first quarter of 2022.

<sup>13</sup> See Options Trader Alert 2021-63.

<sup>14</sup> The OCC data from December 2021 numbers reflect only 13 trading days as this

<u>Date</u>	<u>Total Contracts</u>	<u>Customer Sides</u>	<u>Trading Days</u>	<u>Quarter Contracts</u>	<u>Quarter Cust Sides</u>	<u>Quarter ADC</u>	<u>Quarter Cust ADS</u>
Jan 2021	838,339,790	784,399,878	19				
Feb 2021	823,413,002	782,113,450	19				
Mar 2021	898,653,388	837,247,059	23	2,560,406,180	2,403,760,387	<b>41,973,872</b>	<b>39,405,908</b>
Apr 2021	711,388,828	667,208,963	21				
May 2021	718,368,993	659,913,862	20				
Jun 2021	866,099,522	809,242,842	22	2,295,857,343	2,136,365,667	<b>36,442,180</b>	<b>33,910,566</b>
Jul 2021	790,038,364	729,239,647	21				
Aug 2021	801,578,079	741,111,748	22				
Sep 2021	811,458,905	744,936,837	21	2,403,075,348	2,215,288,232	<b>37,548,052</b>	<b>34,613,879</b>
Oct 2021	821,102,002	760,524,395	21				
Nov 2021	944,355,975	866,102,667	21				
Dec 2021	561,154,417	503,350,470	13	2,326,612,394	2,129,977,532	<b>42,302,044</b>	<b>38,726,864</b>

To date, fourth quarter options average daily volume in 2021 has been higher than options average daily volume in any of the prior three quarters of 2021. With respect to customer options volume across the industry, total customer options contract average daily volume, to date, in 2021 is 36,565,398 as compared to total customer options contract average daily volume in 2020 which was 27,002,511.<sup>15</sup>

There can be no assurance that the Exchange's costs for 2022 will not differ materially from these expectations and prior practice, nor can the Exchange predict with certainty whether options volume will remain at the current level going forward. The Exchange notes however, that when combined with regulatory fees and fines, the revenue that may be generated utilizing an ORF rate of \$0.0042 per contract side may result in revenue which exceeds the Exchange's estimated regulatory costs for 2022 if options volume persists. In 2021, options volume remained high, due in large part to the extreme volatility in the marketplace as a result of the COVID-19 pandemic. The Exchange therefore proposes to reduce its ORF to \$0.0034 per contract side to ensure that revenue does not exceed the Exchange's estimated regulatory costs in 2022. Particularly, the Exchange believes that reducing the ORF when combined with all of the Exchange's other regulatory fees and fines, would allow the Exchange to continue covering a

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information is through December 17, 2021. Volume data in the table represents numbers of contracts; each contract has two sides.

<sup>15</sup> See data from OCC at: <https://www.theocc.com/Market-Data/Market-Data-Reports/Volume-and-Open-Interest/Volume-by-Account-Type>.

material portion of its regulatory costs, while lessening the potential for generating excess revenue that may otherwise occur using the rate of \$0.0042 per contract side.<sup>16</sup>

The Exchange will continue to monitor the amount of revenue collected from the ORF to ensure that it, in combination with its other regulatory fees and fines, does not exceed regulatory costs. If the Exchange determines regulatory revenues exceed regulatory costs, the Exchange will adjust the ORF by submitting a fee change filing to the Commission and notifying<sup>17</sup> its members and member organizations via an Options Trader Alert.<sup>18</sup>

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>19</sup> Specifically, the Exchange believes the proposed rule change is consistent with Section 6(b)(4) of the Act<sup>20</sup>, which provides that Exchange rules may provide for the equitable allocation of reasonable dues, fees, and other charges among its members, member organizations, and other persons using its facilities. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>21</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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<sup>16</sup> The Exchange notes that its regulatory responsibilities with respect to member and member organization compliance with options sales practice rules have largely been allocated to FINRA under a 17d-2 agreement. The ORF is not designed to cover the cost of that options sales practice regulation.

<sup>17</sup> The Exchange will provide members and member organizations with such notice at least 30 calendar days prior to the effective date of the change.

<sup>18</sup> The Exchange notes that in connection with this proposal, it provided the Commission confidential details regarding the Exchange’s projected regulatory revenue, including projected revenue from ORF, along with a projected regulatory expenses.

<sup>19</sup> 15 U.S.C. 78f(b).

<sup>20</sup> 15 U.S.C. 78f(b)(4).

<sup>21</sup> 15 U.S.C. 78f(b)(5).

The Exchange believes the proposed fee change is reasonable because customer transactions will be subject to a lower ORF fee than the rate that would otherwise be in effect on February 1, 2022. Moreover, the proposed reduction is necessary for the Exchange to avoid collecting revenue, in combination with other regulatory fees and fines, that would be in excess of its anticipated regulatory costs which is consistent with the Exchange's practices.

The Exchange had designed the ORF to generate revenues that would be less than the amount of the Exchange's regulatory costs to ensure that it, in combination with its other regulatory fees and fines, does not exceed regulatory costs, which is consistent with the view of the Commission that regulatory fees be used for regulatory purposes and not to support the Exchange's business operations. As discussed above, however, after review of its regulatory costs and regulatory revenues, which includes revenues from ORF and other regulatory fees and fines, the Exchange determined that absent a reduction in ORF, it may collect revenue which would exceed its regulatory costs. Indeed, the Exchange notes that when taking into account the potential that recent options volume persists, it estimates the ORF may generate revenues that would cover more than the approximated Exchange's projected regulatory costs. As such, the Exchange believes it's reasonable and appropriate to reduce the ORF amount from \$0.0042 to \$0.0034 per contract side.

The Exchange also believes the proposed fee change is equitable and not unfairly discriminatory in that it is charged to all member organizations on all their transactions that clear in the customer range at OCC.<sup>22</sup> The Exchange believes the ORF ensures fairness by assessing higher fees to those member organizations that require more Exchange regulatory services based on the amount of customer options business they conduct. Regulating customer trading activity

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<sup>22</sup> If the OCC clearing member is a Phlx member organization, ORF will be assessed and collected on all cleared customer contracts (after adjustment for CMTA); and (2) if the OCC clearing member is not a Phlx member organization, ORF will be collected only on the cleared customer contracts executed at Phlx, taking into account any CMTA instructions which may result in collecting the ORF from a non-member organization.



is much more labor intensive and requires greater expenditure of human and technical resources than regulating non-customer trading activity, which tends to be more automated and less labor-intensive. For example, there are costs associated with main office and branch office examinations (e.g., staff expenses), as well as investigations into customer complaints and the terminations of registered persons. As a result, the costs associated with administering the customer component of the Exchange's overall regulatory program are materially higher than the costs associated with administering the non-customer component (e.g., member and member organization proprietary transactions) of its regulatory program. Moreover, the Exchange notes that it has broad regulatory responsibilities with respect to activities of its members and member organizations, irrespective of where their transactions take place. Many of the Exchange's surveillance programs for customer trading activity may require the Exchange to look at activity across all markets, such as reviews related to position limit violations and manipulation. Indeed, the Exchange cannot effectively review for such conduct without looking at and evaluating activity regardless of where it transpires. In addition to its own surveillance programs, the Exchange also works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in the Intermarket Surveillance Group ("ISG")<sup>23</sup> the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. Accordingly, there is a strong nexus between the ORF and the Exchange's regulatory activities with respect to customer trading activity of its members and member organizations.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. This proposal

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<sup>23</sup> ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG's information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.

does not create an unnecessary or inappropriate intra-market burden on competition because the ORF applies to all customer activity, thereby raising regulatory revenue to offset regulatory expenses. It also supplements the regulatory revenue derived from non-customer activity. The Exchange notes, however, the proposed change is not designed to address any competitive issues. Indeed, this proposal does not create an unnecessary or inappropriate inter-market burden on competition because it is a regulatory fee that supports regulation in furtherance of the purposes of the Act. The Exchange is obligated to ensure that the amount of regulatory revenue collected from the ORF, in combination with its other regulatory fees and fines, does not exceed regulatory costs.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change is effective upon filing pursuant to Section 19(b)(3)(A)<sup>24</sup> of the Act and subparagraph (f)(2) of Rule 19b-4<sup>25</sup> thereunder, because it establishes a due, fee, or other charge imposed by the Exchange.

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings under Section 19(b)(2)(B)<sup>26</sup> of the Act to determine whether the proposed rule change should be approved or disapproved.

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<sup>24</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>25</sup> 17 CFR 240.19b-4(f)(2).

<sup>26</sup> 15 U.S.C. 78s(b)(2)(B).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-Phlx-2022-03 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-Phlx-2022-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All

submissions should refer to File No. SR-Phlx-2022-03, and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>27</sup>

**J. Matthew DeLesDernier,**  
*Assistant Secretary.*

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<sup>27</sup> 17 CFR 200.30-3(a)(12).